(6)

Supreme Court, U.S.
FILED
MAR 7 - 1995
OFFICE OF THE CLERK

No. 94-1340

In The

Supreme Court of the United States

October Term, 1994

CITIZENS BANK OF MARYLAND,

Petitioner,

v.

DAVID STRUMPF,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

BRIEF *AMICI CURIAE* IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

JOHN H. CULVER III
Counsel of Record
AMY L. PRITCHARD
KENNEDY COVINGTON
LOBDELL & HICKMAN, L.L.P.
NationsBank Corporate Center
Suite 4200
100 North Tryon Street
Charlotte, North Carolina 28202-4006
(704) 331-7400
Counsel for NationsBank, N.A. (Carolinas), NationsBank, N.A., and The First National Bank of Maryland

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

BEST AVAILABLE COPY

26 pp

QUESTION PRESENTED FOR REVIEW

Whether a bank creditor may refuse a bankrupt depositor's request to withdraw funds pending determination by the bankruptcy court of the bank's setoff rights, without violating the bankruptcy stay under 11 U.S.C. § 362(a).

TABLE OF CONTENTS

Page

I. INTEREST OF THE AMICI CURIAE 1

II. SUMMARY OF ARGUMENT 4

III. ARGUMENT 4

A. Special and important reasons support the issuance of the writ in this case 4

1. The decision furthers a conflict among jurisdictions that impedes the ability of banks to engage in interstate banking 5

a. Jurisdictions are currently divided as to permissibility of the administrative freeze pending relief from the automatic stay 5

b. The widespread conflict among jurisdictions increases the costs of developing and managing interstate branch banking 9

2. The decision improperly discriminates against bank creditors by creating an artificial distinction between banks and all other creditors that may owe money to debtors 12

B. The question presented by the petition is an important question of federal law 16

IV. CONCLUSION 20

TABLE OF AUTHORITIES

Page

CASES

Citizens Bank of Maryland v. Strumpf, 37 F.3d 155 (4th Cir. 1994) ..... *passim*

In re Archer, 34 B.R. 28 (Bankr. N.D. Tex. 1983)..... 13

In re Davis, 889 F.2d 658 (5th Cir. 1989), *cert. denied* 495 U.S. 933 (1990) 5, 7, 16, 18

In re Edgins, 36 B.R. 480 (9th Cir. BAP 1984) .. 8, 16, 18

In re Ehrman, 171 B.R. 683 (Bankr. D. Ariz. 1994) 8

In re First Conn. Small Business Investment Co., 118 B.R. 179 (Bankr. Conn. 1990)..... 9

In re Fulghum Construction Corp., 23 B.R. 147 (Bankr. M.D. Tenn. 1982) 15

In re G.S. Omni Corp., 835 F.2d 1317 (10th Cir. 1987)..... 14

In re Patterson, 967 F.2d 505 (11th Cir. 1992)... 5, 7, 17, 18

In re Suncrete Corporation, 21 C.B.C. 2d 185 (Bankr. M.D. Fla. 1989)..... 14

In re Williams, 61 B.R. 567 (Bankr. N.D. Texas 1986) ..8, 18

In re Windmill Farms, Inc., 70 B.R. 618 (9th Cir. BAP 1987) *rev'd on other grounds* 841 F.2d 1467 (9th Cir. 1988) 8

Keller v. Fredicktown Savings Institute, 66 A.2d 924 (Md. 1949) 6

New York County National Bank v. Massey, 192 U.S. 138 (1904)..... 6

Posey v. Internal Revenue Service, 156 B.R. 910 (W.D.N.Y. 1993) 14

TABLE OF AUTHORITIES – Continued

Page

Small Business Administration v. Rinehart, 887 F.2d 165 (8th Cir. 1989) 5, 6, 7

United States v. Norton, 717 F.2d 767 (3rd. Cir. 1983) 5, 6, 7, 8

United States v. Reynolds, 764 F.2d 1004 (4th Cir. 1985) 5, 6, 7, 8

STATUTES

11 U.S.C. § 362(a) ..... *passim*

11 U.S.C. § 363 ..... *passim*

11 U.S.C. § 506(a) 14, 16, 17, 18

11 U.S.C. § 542 ..... *passim*

11 U.S.C. § 553 ..... *passim*

12 U.S.C. § 30 9

12 U.S.C. § 36 9

U.C.C. § 9-306(2) (1978) 13, 18

MISCELLANEOUS

Groschadl, *Freezing the Debtor's Bank Account: A Violation of the Automatic Stay?*, 57 Am. Bankr. L.J. 75 (1983) 18

H.R. Rep. No. 595, 95th Cong., 1st Sess. 369 (1977) 13

H.R. Rep. No. 448, 103 Cong., 2d Sess. 19 (1994) *reprinted in* 1994 U.S. Code Cong. & Ad. News 2039 ..... 10, 11, 12

TABLE OF AUTHORITIES – Continued

Page

2 James W. Moore & Lawrence P. King, *Collier on Bankruptcy* ¶ 363.02 (15th ed. 1994) 17

2 James W. Moore & Lawrence P. King, *Collier on Bankruptcy*, ¶ 363.04 (15th ed. 1994) 18

S. Rep. No. 989, 95th Cong., 2d. Sess., 84 (1978) 13

Stephen C. Mount, Note, *Standards and Sanctions for Use of Cash Collateral Under the Bankruptcy Code*, 63 Tex. L. Rev. 341 (1984) 18

No. 94-1340

In The

Supreme Court of the United States

October Term, 1994

CITIZENS BANK OF MARYLAND,

Petitioner,

v.

DAVID STRUMPF,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

BRIEF *AMICI CURIAE* IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

I. INTEREST OF THE AMICI CURIAE

NationsBank, N.A. (Carolinas), NationsBank, N.A., and The First National Bank of Maryland[1] (collectively

[1] Pursuant to Supreme Court Rule 29.1, the Banks disclose the following: The parent company of NationsBank, N.A. and NationsBank, N.A. (Carolinas) is NB Holdings Corporation. NationsBank, N.A.'s only direct subsidiary (other than wholly owned subsidiaries) is Suburban Artery Limited Partnership. NationsBank, N.A. (Carolinas) has no direct subsidiaries that are not wholly owned. The parent company of The First National Bank of Maryland is First

the "Banks") hereby respectfully file their brief *amici curiae* in this case. The consent of the attorneys for the petitioner and the respondent has been obtained.

The United States Court of Appeals for the Fourth Circuit (the "Fourth Circuit") in *Citizens Bank of Maryland v. Strumpf*, 37 F.3d 155, 157 (4th Cir. 1994) (the "Decision"), held that a bank violates the automatic stay of 11 U.S.C. § 362(a) by placing an administrative hold on a debtor's deposit account while seeking relief from the automatic stay to exercise the right of setoff. The interest of the Banks in this case arises from the burden that this decision places upon their operations. Each of the amici are regional banks. NationsBank, N.A. and NationsBank, N.A. (Carolinas) currently operate in more than one state. NationsBank, N.A. operates in more than one federal judicial circuit. Because each of the Banks has an interest in regional banking, they are in a unique position to delineate the effect the Fourth Circuit's decision will have on the banking industry.

NationsBank, N.A. and NationsBank, N.A. (Carolinas) are national banking associations with banking operations in Maryland and the District of Columbia for NationsBank, N.A. and North Carolina and South Carolina for NationsBank N.A. (Carolinas). Both banks are direct subsidiaries of NB Holdings Corporation, which owns other banking associations in Florida, Georgia, Kentucky, Tennessee, Texas, and Virginia. The First National Bank of Maryland is also a national banking association

---

Maryland Bancorp. The First National Bank of Maryland has no direct subsidiaries that are not wholly owned.

with operations in Maryland. Each of the Banks has numerous customers that live in one state and maintain bank accounts in another state. The issue of whether a creditor may refuse to pay debts to a debtor to protect its right to setoff pending relief from the automatic stay is a fundamental aspect of post-petition debtor-creditor relations and is raised in countless bankruptcy cases.

The current conflict among the circuits and among the various district and bankruptcy courts has serious consequences for the Banks. For example, NationsBank, N.A. operates branches in both the Fourth Circuit and the District of Columbia Circuit. The conflict leaves NationsBank, N.A. with no guidance as to what action to take when a customer who resides in the District of Columbia but banks in Maryland files for bankruptcy relief in the District of Columbia.

Although administrative holds are not prohibited by the bankruptcy court for the District of Columbia, NationsBank, N.A. risks a violation of the stay and resulting sanctions if it freezes demand deposit accounts in both jurisdictions. Of course, the debtor/borrower can effectively circumvent a hold communicated only to branches located in the District of Columbia by withdrawing funds from branches located in Maryland. Moreover, as the prohibitions on interstate banking relax, and banks begin to engage in banking across multiple state lines, banks will be required to maintain separate systems for tracking and monitoring demand deposit accounts in each jurisdiction if the Decision is allowed to stand. The Banks are in a unique position to address the serious negative consequences of the *Strumpf* holding for those who currently engage in interstate banking and those

who intend to pursue the benefits of recent legislation permitting banks to operate branches in more than one state.

II. SUMMARY OF ARGUMENT

The Decision conflicts with decisions from the Eleventh and Fifth Circuits. Moreover, conflicting decisions regarding the appropriateness of an administrative hold in a bankruptcy setting are proliferating rapidly in the lower courts of virtually all circuits, and the need for guidance from this Court is acute. This conflict directly burdens banks that currently engage in interstate banking. The Decision also conflicts with the purposes of the Interstate Banking Act and will impede the purpose and intent of that legislation.

The Decision is contrary to both the language and the policies underlying the United States Bankruptcy Code (the "Bankruptcy Code"). The opinion, which addresses those policies in a cursory fashion, fails to address the tension created by the various sections of the Bankruptcy Code that create and govern the debtor's and creditor's rights in cash collateral. The opinion ignores certain sections of the Bankruptcy Code that directly create a specific balance of rights.

III. ARGUMENT

A. Special and important reasons support the issuance of the writ in this case.

The Decision furthers a division among the courts. The conflict among jurisdictions will seriously interfere

with the efficient development of interstate banking. Further, the decision improperly discriminates against bank creditors by creating an artificial distinction between lending institutions and other creditors who possess setoff rights.

1. The decision furthers a conflict among jurisdictions that impedes the ability of banks to engage in interstate banking.

a. Jurisdictions are currently divided as to permissibility of the administrative freeze pending relief from the automatic stay.

Although the Fourth Circuit viewed its decision as one of first impression among circuit courts, it recognized that several circuit courts have addressed very similar questions. *Citizens Bank of Maryland v. Strumpf*, 37 F.3d 155, 157 (4th Cir. 1994). In fact, the circuit courts are divided as to the issue presented to this Court in the petition for writ of *certiorari* (the "Petition"). *Cf. Small Business Administration v. Rinehart*, 887 F.2d 165 (8th Cir. 1989), *United States v. Reynolds*, 764 F.2d 1004 (4th Cir. 1985), *United States v. Norton*, 717 F.2d 767 (3rd. Cir. 1983) *with In re Patterson*, 967 F.2d 505 (11th Cir. 1992) *and In re Davis*, 889 F.2d 658 (5th Cir. 1989), *cert. denied*, 495 U.S. 933 (1990).

The Fourth Circuit held that "an administrative hold is tantamount to the exercise of the right of setoff and thus violates the automatic stay." *Strumpf*, 37 F.3d at 158. The crux of the opinion in *Strumpf* is that the Bankruptcy Code not only permits, but requires, that the debtor have

use of deposited[2] funds, which are potentially subject to setoff, pending a judicial determination of the right of setoff. *Strumpf*, 37 F.3d at 158-159. In *Norton* and *Reynolds*, the Courts of Appeals for the Third and Fourth Circuits each held that the IRS violated the automatic stay by freezing[3] funds owed to a debtor in order to preserve its right to setoff. *Norton*, 717 F.2d at 771-771; *Reynolds*, 764 F.2d at 1007. In *Rinehart*, the Court of Appeals for the Eighth Circuit similarly determined that the creditor exercised control over funds of the debtor in violation of section 362(a)(3) by refusing to turnover funds owing to the debtor. *Rinehart*, 887 F.2d at 169.

The analysis employed by the courts in each of these cases is nearly identical. Each court focused almost exclusively on the relationship between sections 362 and 553 of

[2] Depositors commonly misperceive the nature of a bank deposit. It is well established that a general bank deposit creates a debtor-creditor relationship between the bank and the depositor. The bank simply owes a debt to the depositor which is payable on demand. *New York County Nat'l Bank v. Massey*, 192 U.S. 138 (1904); *Keller v. Fredicktown Sav. Inst.*, 66 A.2d 924, 925 (Md. 1949).

[3] A freeze, an administrative freeze, or a hold is nothing more than a bank's way of communicating that it declines to pay its debts to a depositor. Unlike smaller businesses, financial institutions face significant communicative and technological difficulties in manifesting an intent not to pay. When a bank determines that it does not wish to pay all or a portion of a debt that it owes to a depositor, then the bank must notify every teller at every branch in every state where it has operations as well as all Automatic Teller Machines ("ATMS"). The only way that a bank can accomplish this is by electronically coding its computers. This electronic coding is commonly referred to as an "administrative freeze" or an "administrative hold."

the Bankruptcy Code and failed to consider section 542(b) in determining the respective rights of debtor and creditor. *See Strumpf*, 37 F.3d at 157, n.* (mentioning section 542 in footnote only); *Rinehart*, 887 F.2d at 168-169; *Reynolds*, 764 F.2d at 1006 (creditor's contention "involves two sections of the Bankruptcy Code:" sections 362 and 553); *Norton*, 717 F.2d at 771 ("The interaction of sections 553 and 362 and the precise meaning of the term setoff form the core issue of this case."). The Fourth Circuit relied heavily on *Reynolds* in its analysis, and also noted that *Norton* and *Rinehart* "are on slightly different facts but are fully in accord with our decision." 37 F.3d at 158.

In contrast, the Fifth Circuit has held that a creditor should not be penalized for refusing to turn funds over to the debtor pending the final disposition of claims between the creditor and debtor. *Davis*, 889 F.2d at 662-663. In *Davis*, the court noted that creditors should not be punished for delaying payment until the amount of claims is finally determined because "otherwise the right to setoff is worth little more than the book in which it is found." *Id.* at 662. Although the court in *Davis* did not specifically rely on section 542, the decision recognizes a creditor's right to refuse to pay a debt to the debtor if necessary to protect setoff rights. *Id.* at 661-662.

Alternatively, the Eleventh Circuit Court of Appeals, while finding that an administrative hold is not permissible, encouraged banks to pay funds subject to setoff into the registry of the court and seek *ex parte* relief from the bankruptcy court. *Patterson*, 967 F.2d at 511. The court in *Patterson* noted that this approach would protect banks from the risk that funds subject to a valid right of setoff would be dissipated before the entitlement to set off the

funds could be established. *Id.* This holding is directly contrary to the conclusion of the Fourth Circuit that a hold on an account is impermissible because it "deprive[s] the debtor of the use of the funds pending the outcome of the motion for relief from stay." *Strumpf*, 37 F.3d at 158. Further demonstrating the differences in the views of the Eleventh Circuit and Fourth Circuit, the Fourth Circuit also stated that section 362 allows a debtor to defeat a creditor's right of setoff. 37 F.3d at 159.

The Bankruptcy Appellate Panel of the Ninth Circuit has held that a bank may place an administrative hold on funds subject to setoff prior to receiving relief from stay. *In re Edgins*, 36 B.R. 480 (9th Cir. BAP 1984).[4] In contrast to the opinions in *Strumpf*, *Reynolds* and *Norton*, the panel in *Edgins* recognized that "[t]his case, despite its simple facts, involves interaction of the automatic stay of 11 U.S.C. section 362, setoffs under 11 U.S.C. section 553, turnover of property under 11 U.S.C. section 542(b), determination of secured status under 11 U.S.C. section 506(a), and use of cash collateral under 11 U.S.C. section 363." 36 B.R. at 482.

Finally, as noted in the petitioner's brief, widespread confusion exists at both the district court and bankruptcy court level on this issue. Bankruptcy courts without guidance from their own circuit or district court cite conflicting authority and devise their own solutions. *See e.g. In re*

[4] Decisions by the Bankruptcy Appellate Panel constitute binding precedent on all bankruptcy courts within the Ninth Circuit. *In re Windmill Farms, Inc.*, 70 B.R. 618 (9th Cir. BAP 1987) *rev'd on other grounds* 841 F.2d 1467 (9th Cir. 1988); *In re Ehrman*, 171 B.R. 683 (Bankr. D. Ariz. 1994).

Williams, 61 B.R. 567, 572 (Bankr. N.D. Texas 1986) (noting that issue has "sparked intense debate in the courts and among commentators" and finding hold permissible) and *In re First Conn. Small Business Inv. Co.*, 118 B.R. 179, 181 (Bankr. Conn. 1990) (noting that issue "has been the subject of conflicting decisions and commentary" and finding that hold violates stay). This conflict currently creates uncertainty for banks operating in districts lacking authority on the issue and increases the legal and administrative costs incurred when a customer files for bankruptcy.

b. The widespread conflict among jurisdictions increases the costs of developing and managing interstate branch banking.

The lack of uniform treatment creates practical problems for banks operating in more than one state. If freezes are permitted in some jurisdictions but not in others, then banks must devise methods for allowing some branches to implement an administrative freeze but not others. Already this conflict poses difficulties for regional lenders such as the Banks.[5] As interstate branch banking develops, the lack of uniformity and certainty

[5] Pursuant to 12 U.S.C. §§ 30 and 36, NationsBank, N.A. already operates multistate branches in both the District of Columbia and Maryland, and NationsBank, N.A. (Carolinas) operates branches in North and South Carolina. These two sections permit the creation of unified multistate banks so long as their headquarters are within thirty miles of each state's boundary. NB Holdings Corporation created NationsBank, N.A. as its first unified multistate bank in 1994.

will become an even more costly problem. As such, the conflict between jurisdictions runs directly contrary to an important goal of Congress in passing landmark interstate banking and branching laws in 1994.

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Interstate Banking Act") was passed by Congress in 1994 and will become effective in September, 1995.[6] The Interstate Banking Act reversed the established policy of restricting a bank's ability to operate branches in more than one state. H.R. Rep. No. 448, 103 Cong., 2d Sess. 19 (1994) *reprinted in* 1994 U.S. Code Cong. & Ad. News 2039, 2042 (hereinafter H.R.Rep. No. 448).

A primary goal of the Congress in passing the Interstate Banking Act was to promote greater flexibility and efficiency in the national banking system. As stated in the legislative history, "enacting this bill will yield important benefits to the banking system and to the nation's economy. First, it will give banks an opportunity to structure themselves more efficiently, eliminate duplicative functions, and reduce expenses . . . ." H.R. Rep. No. 448 at 19, 1994 U.S. Code Cong. & Ad. News at 2042, *quoting* Letter of Under Secretary of the Treasury Frank N. Newman. Remarks by Representative Neal and Representative McCollum further evidence congressional intent to

[6] The Interstate Banking Act will generally permit bank holding companies to acquire banks in any state beginning on September 29, 1995. Beginning in 1997, banks will be permitted to engage in interstate branch banking through merger or by establishing new branches in foreign states.

improve banking efficiency and expand the geographic scope of banking operations,

> Liberalized interstate banking and branching laws will also give banks greater organizational and operational freedom. Currently, the banking industry is the only industry in the nation in which corporations are permitted to operate across state's lines only if they establish a separate company in each state. Many bankers view this requirement as wasteful, because its mandates multiple boards of directors and regulatory reports, and forces transactions between different banks within the same holding company to be carried out in an arm-lengths manner . . . .

H.R. Rep. No. 448 at 19, 1994 U.S. Code Cong. & Ad. News at 2062. The Congressmen's remarks also emphasize the importance of allowing banks to engage in business across the country and thus expand the geographic scope of banking activities. H.R. Rep. No. 448 at 19, 1994 U.S. Code Cong. & Ad. News at 2064.

Absent a resolution of the conflict between jurisdictions on this issue, banks operating branches in more than one state will face different rules governing the permissibility of protecting their rights through an administrative freeze prior to receiving relief from the automatic stay. Banks will be compelled to identify customers who reside in districts permitting administrative freezes and treat those customers differently than those who file for bankruptcy in districts where the freeze is

not permitted.[7] The cost of devising a solution to this problem and the continuing administrative costs of managing duplicate systems are exactly the kinds of costs Congress sought to reduce or eliminate in introducing interstate banking.

2. The decision improperly discriminates against bank creditors by creating an artificial distinction between banks and all other creditors that may owe money to debtors.

The Court should grant the Petition because the Decision treats banks differently from all other creditors in the absence of a statutory basis for doing so. In failing to recognize that an administrative hold or an administrative freeze is nothing more than a mere declination of payment of a debt, the Decision denies statutory rights to banks that are afforded to other creditors. Specifically, the Decision treats a bank's election to exercise its rights under section 542(b) as a violation of the automatic stay, while other creditors routinely exercise these rights without penalty.

Under section 542(b), Congress expressly protected the setoff rights of creditors by providing that although all creditors are required to pay a debtor immediately upon demand all sums that they owe, creditors are also

[7] This task is made more complicated by the number of potential individual debtors who live in one federal district but work in another. The legislative history to the Interstate Banking Act points out that four million Americans commute daily to and from work across state lines. H.R. Rep. No. 448 at 57, U.S. Code Cong. & Ad. News at 2057.

entitled to refrain from paying any sums owed to the extent they have setoff rights. Individual and small business creditors exercise their rights under section 542(b) by simply not paying. As a practical matter there is nothing more they need to do to manifest and effectuate their intent not to pay on demand; they simply decline to make a payment.

As discussed above, however, banks encounter significantly greater difficulties in manifesting an intent not to pay because a bank must communicate its election to decline payment to numerous tellers and ATMS. Absent the ability to communicate such an instruction to its branches and ATMS, banks are unable to protect their rights under sections 542(b) and 553. Once a debtor has withdrawn funds from a deposit account or permitted others to withdraw such funds (by continuing to write checks on such account) then the bank's right of setoff is extinguished. U.C.C. § 9-306(2) (1978). *See e.g. In re Archer*, 34 B.R. 28 (Bankr. N.D. Tex. 1983) (turnover of funds extinguished setoff rights although monies constitute cash collateral).

A fundamental policy recognized by the Bankruptcy Code is parity of treatment among similarly situated creditors. Section 542 draws no distinction between lending institutions and other creditors. To the contrary, the legislative history of section 542 explicitly anticipates that it will apply to banks. H.R. Rep. No. 595, 95th Cong., 1st Sess. 369 (1977); S. Rep. No. 989, 95th Cong., 2d. Sess. 84 (1978). The Decision, therefore, violates the express congressional intent behind section 542.

Two other sections of the Bankruptcy Code provide supplemental protection to bank creditors with a right of setoff. The Bankruptcy Code treats creditors with a right of setoff as secured to the extent of the amount of their claim subject to setoff. 11 U.S.C. § 506(a). The Bankruptcy Code also treats deposit accounts as cash collateral pursuant to section 363(a). Debtors are specifically prohibited from using cash collateral absent consent from the secured creditor or court authorization after notice and a hearing. Thus, to the extent that a bank holds a pre-petition claim against the debtor, section 363 prohibits the debtor from using the deposits on account. Given the status of a bank with setoff rights as a secured creditor under section 506(a) and the additional protection given to cash collateral by section 363, there is no basis for concluding that Congress meant to treat banks less favorably than other creditors with setoff rights.

In cases addressing demands for turnover under section 542 made on creditors other than banks, courts routinely recognize the right of a creditor with setoff rights to refuse a demand for payment by the debtor pursuant to sections 542(b) and 553. *See e.g. In re G.S. Omni Corp.*, 835 F.2d 1317, 1318 (10th Cir. 1987) (existence of valid setoff rights a proper defense to turnover action); *In re Suncrete Corporation*, 21 C.B.C.2d 185, 188 (Bankr. M.D. Fla. 1989) (creditor not required to file proof of claim in order to assert affirmative defense of setoff in turnover action); *Posey v. Internal Revenue Service*, 156 B.R. 910, 916 (W.D.N.Y. 1993) (sections 542(b) and 553 permit creditor with valid setoff rights to refuse to pay pre-petition debt to debtor even where proceeds of debt would constitute exempt property of debtor). There is no suggestion in

these cases that the creditors effectuated setoff or otherwise violated the automatic stay by refusing to pay a debt to the debtor. *See also In re Fulghum Construction Corp.*, 23 B.R. 147 (Bankr. M.D. Tenn. 1982) (Although creditor should have filed a motion for relief from stay to present issue to court early in case, it was nonetheless proper to assert a right of setoff in answer to turnover complaint. Trustee not entitled to recover amount owed to debtor under pre-petition contract where amount owed by debtor to creditor exceeds amount outstanding on contract).

The administrative hold is the only mechanism available to a bank to evidence and effectuate its declination to pay. A bank's rights are no different than those afforded to a sole proprietor, or a small business, except that the refusal to pay is communicated to employees and machines electronically due to the technological and geographic demands of a large financial institution. The decision in *Strumpf* inappropriately treats banks differently from other creditors by removing the only way they may protect their statutory rights. Such disparate treatment is not contemplated by the statutory language articulated by Congress, nor is there any secondary evidence of a Congressional intent to impose such disparate treatment. Accordingly, the Banks request that this Court grant the Petition in order to ensure that all creditors possessing setoff rights receive the same treatment under the Bankruptcy Code.

B. The question presented by the petition is an important question of federal law.

The Banks also request that the Court grant the Petition because the Fourth Circuit erred in ruling that Citizens violated the automatic stay. The Decision is in error because it failed to recognize Citizens' rights under section 542, the nature of the frozen funds as cash collateral and the prohibition imposed by the Bankruptcy Code on the use of such cash collateral.

Section 542(b) requires creditors that owe a debt to the debtor to pay such debt, except to the extent that the debt may be offset under section 553 against a claim against the debtor. 11 U.S.C. § 542(b).[8]

Thus, section 542(b) permits creditors with a right of setoff under state law to refuse a demand by the debtor that the debt be paid. *See Davis*, 889 F.2d at 661. Although a creditor must receive relief from stay as a precondition to setting off amounts owed to the debtor from amounts owed by the debtor, the creditor is permitted to protect his right to do so pending a hearing on the matter. *Id; Edgins*, 36 B.R. at 483.

If a creditor has a valid setoff right, the Bankruptcy Code provides that the creditor's claim is secured to the "extent of the amount subject to setoff." 11 U.S.C. § 506(a). Financial institutions, whose collateral includes

[8] Section 553 preserves a creditor's otherwise existing right of setoff, but prevents a creditor from actually exercising that right until the creditor has obtained relief from the automatic stay. 11 U.S.C. § 553(a).

"cash collateral," such as demand deposits, receive special protection because of the unique nature of their collateral. 11 U.S.C. § 363. Specifically, debtors are prohibited from using cash collateral absent consent from the creditor or court authorization after notice and hearing. 11 U.S.C. § 363(c). Creditors secured by reason of a right of setoff against a deposit account are included within the protection of section 363. 2 James W. Moore & Lawrence P. King, *Collier on Bankruptcy* ¶ 363.02 (15th ed. 1994).

As noted by the Bankruptcy Appellate Panel in *Edgins*, this statutory framework establishes a "stalemate" or balance with regard to the funds subject to setoff. *Edgins*, 36 B.R. at 483. Neither the creditor nor the debtor can place those funds permanently out of the reach of the other without court authority. *Id. See also, Patterson*, 967 F.2d at 511. This situation can be altered by the court upon request of either the debtor (by filing a motion for permission to use the cash collateral pursuant to section 363 or for turnover pursuant to section 542) or the creditor (by filing a motion for relief from stay). *Id.*

The Fourth Circuit analyzed the stay issue without reference to the important rights extended to creditors by sections 542(b), 506(a) and 363. Although the Decision notes sections 542 and 506, it makes no effort to apply those provisions to the facts of the case. *Strumpf*, 37 F.3d at 157, n.*. Rather, the Court reviewed only section 362(a)(7) and section 553. In so doing, the Court ignored the statutory balance created by the Bankruptcy Code.

The Fourth Circuit did not recognize the nature of the deposit account as cash collateral. In reaching its

decision, the court stated that a freeze was tantamount to an actual setoff because it deprived the debtor of its use of the funds. 37 F.3d at 158. The court also stated that pursuant to 362(a)(7), the debtor was permitted to use the funds, even if this ultimately defeated the creditor's right of setoff. 37 F.3d at 159. That incorrect premise is directly contrary to the provisions of section 506(a) and 363. *Edgins*, 36 B.R. at 483; *See also, Patterson*, 967 F.2d at 511.

Under the Decision, banks are now subject to the risk that they may not obtain the intervention of the courts until after the funds are dissipated. Even judicial intervention may have little meaning, however, because when cash is turned over to the debtor and no longer identified, it may lose its character as cash *collateral*. *See Davis*, 889 F.2d at 662; *Patterson*, 967 F.2d at 511. Once the cash is commingled with other cash or spent by the debtor, it is no longer identifiable and may not be subject to the bank's security interest. U.C.C. § 9-306(2). This result is contrary to the statutory language and policy of the Bankruptcy Code. *Edgins*, 36 B.R. at 483-84. Further, the rule set forth in the decision invites abuse for which there is no effective remedy.[9]

---

[9] Although prohibited from using cash collateral under the Bankruptcy Code, not all debtors carry out that statutory duty. *Williams*, 61 B.R. at 576; Groschadl, *"Freezing the Debtor's Bank Account: A Violation of the Automatic Stay?,"* 57 Am. Bankr. L.J. 75, 77 (1983). The Courts have consistently recognized that there is no true remedy for a debtor's wrongful use of cash collateral, because the cash is gone. This unique risk is explicitly recognized by Section 363. Stephen C. Mount, Note, *Standards and Sanctions for Use of Cash Collateral Under the Bankruptcy Code*, 63 Tex L.Rev. 341 (1984); 2 *Collier on Bankruptcy*, ¶ 363.04 at 363-23.

The facts of this case illustrate well the need to acknowledge the full scope of the statutory framework established by the Bankruptcy Code. Citizens placed a hold on a borrower/debtor's account to the extent of the approximate amount of its claim against the borrower/debtor. After placing the hold, Citizens promptly filed a motion for relief from stay seeking permission to setoff those funds. The bankruptcy court ultimately determined that Citizens had a valid right to setoff Mr. Strumpf's checking account against its pre-petition unsecured claim. However, because the court had previously required Citizens to "unfreeze" the funds on hold, by the time the stay was lifted Citizens could no longer identify the cash that had been its collateral. As a result, Citizens was left with an unsecured claim. If the Decision is allowed to stand, banks will be left without opportunity to enforce rights granted to creditors by the Bankruptcy Code.

IV. CONCLUSION

For these reasons, NationsBank, N.A. (Carolinas), NationsBank, N.A., and The First National Bank of Maryland respectfully request that this Court grant the Petition for Writ of *Certiorari*.

Respectfully submitted this 7th day of March, 1995.

JOHN H. CULVER III
Counsel for Amici Curiae

Of Counsel:

KENNEDY COVINGTON
LOBDELL & HICKMAN L.L.P.
NationsBank Corporate Center
Suite 4200
100 North Tryon Street
Charlotte, North Carolina 28202-4006
(704) 331-7400